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February 10, 1997

Mr. L--- F---
M--- T--- S--- Group
--- & ---, ---
XXX --- --- Drive, Suite XXXX
--- ---, CA XXXXX-XXXX

Re: Sales to Common Carriers
B--- A---, Inc.
Account No. SR -- XX-XXXXXX

Dear Mr. F---

This is in response to your letter of December 17, 1996, in which you requested the Legal Division to reconsider its response to a previous inquiry made by your client B--- A---, Inc., Galley Products Division, A--- F--- (A---).

A---, in its letter of June 12, 1996, inquired about the application of sales tax to refrigerators sold to an airline. Based upon the information contained in the letter, the facts were understood as follows. The airline purchased the refrigerators but directed A--- to deliver the refrigerators to a California manufacturer who utilized these refrigerators in constructing aircraft kitchen galleys. The completed galley, containing the refrigerator, is delivered to an aircraft manufacturer for installation into aircraft. After the galley is installed into the aircraft, the aircraft is delivered, by the aircraft manufacturer, to the airline.

Tax Counsel John Butterfield responded to your client's request for information on September 10, 1996, concluding that the sales of the refrigerators to the airlines were subject to sales tax. In reaching his conclusion, Mr. Butterfield considered whether the sale qualified for the exemptions provided under Revenue and Taxation Code sections 6385, 6396 and 6366. Section 6385 provides an exemption for property purchased by a common carrier which will be used in the purchaser's operations as a common carrier, so long as the property is transported to an out-of-state destination, under a bill of lading, and is not put into use until after the property is transported to the out-of-state location. Mr. Butterfield concluded that this transaction did not qualify for this exemption because the refrigerators were delivered to a manufacturer in California.

Mr. Butterfield next analyzed whether this transaction qualified as an exempt sale in interstate commerce under Revenue and Taxation Code section 6396. This section, which is explained by regulation 1620, exempts from sales tax the gross receipts from sales of tangible personal property which, pursuant to the contract of sale, is required to be shipped and is shipped to a point outside the state by the retailer by means of facilities operated by the retailer or by delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point. Mr. Butterfield concluded that this exemption did not apply because the property was delivered, per the customer's direction, to another location in the state.

Finally, Mr. Butterfield considered whether the purchases of the refrigerators were exempt pursuant to Revenue and Taxation Code section 6366. This section, as explained by Regulation 1593, provides an exemption for sales of aircraft to common carriers. In reaching his determination that this exemption did not apply, Mr. Butterfield considered paragraph (d) of Regulation 1593 which provides that modification, repair or replacement of parts on aircraft prior to removal of the aircraft from California and prior to the aircraft being placed in common carriage operations will not affect the exemption allowed for the purchase of aircraft to be used in common carriage. Mr. Butterfield concluded that this paragraph did not apply because A--- was not the party that installed the refrigerators into the aircraft.

In your letter, you state that important facts were omitted from your client's explanation of the facts. In the first paragraph of your letter you indicate that the refrigerators and galley systems are purchased for installation into "new aircraft." From this statement we assume that the new aircraft is purchased by your client's customers and that the installation of the refrigerators and galley systems constitutes a step in the manufacture of the new aircraft. You submit three scenarios under which the refrigerators sold by A--- are incorporated into new aircraft and request that these scenarios be reanalyzed under Revenue and Taxation Code 6366 and Regulation 1593(d).

"Scenario 1: The refrigerator is sold and delivered to an aircraft manufacturer. The manufacturer incorporates the refrigerator into a galley. The galley is checked to determine that all specifications of the design have been met. After the check, the galley is installed into the aircraft and after the aircraft is completed, it is delivered to a common carrier.

"Scenario 2: The refrigerator is sold to a common carrier who instructs A--- to deliver the refrigerator to a third party galley manufacturer instead of delivering the refrigerator to a common carrier or an aircraft manufacturer. The galley manufacturer designs the galley and installs the refrigerator into the galley. The manufacturer determines that all the specifications of the design have been met. Upon completion, the galley is shipped to the aircraft manufacturer. The aircraft manufacturer installs the galley into the airframe and the finished aircraft is delivered to the common carrier.

“Scenario 3: The refrigerator is sold and shipped directly to a common carrier who instructs a third party to install the refrigerator into a galley that will be incorporated into the finished aircraft.”

In the last two scenarios we assume that the aircraft into which the refrigerator and galley will be installed has also been purchased by the common carrier and that the refrigerator and galley installation is performed per the direction of the common carrier.

BTLG Annotation 105.0190 (1/17/95) explains that the sale and installation of modular kitchens qualifies for the exemption under section 6366, **so long** as they are installed as part of or a step in the manufacture or completion of a new aircraft. Stated another way, if the installation of the refrigerators and galleys occurs after the purchaser has placed the aircraft in common carriage, the exemption does not apply. Thus, under all three scenarios, if the refrigerators are installed as “a part of or a step in the manufacturer completion of the aircraft,” their sale is eligible for the exemption accorded under section 6366, so long as the purchase of the aircraft otherwise qualifies as a common carrier under section 6366, as explained by Regulation 1593.

While not applicable to this particular transaction, section 6366 has been amended to provide, under specified circumstances, that tangible personal property, purchased on or after October 1, 1996, which becomes a component part of aircraft used in common carriage under the authority of the laws of California, the United States or any foreign government shall be exempted from the imposition of California’s sales and use taxes. In order to qualify for this exemption, the addition of the property as a component part of the aircraft must be “as a result of the maintenance, repair, overhaul or improvement of the aircraft in compliance with [FAA] requirements.” In addition any charges for labor and installation of the property in connection with the installation of the subject property shall also be exempt from the imposition of California’s sales and use taxes. (Rev. & Tax. Code § 6366(a) (2).) I have enclosed a copy of amended section 6366 for your convenience. If you have any further questions, please feel free to contact this office again.

Sincerely,

Patricia Hart Jorgensen
Senior Tax Counsel

PHJ:cl

Enclosure (Revenue and Taxation Code § 6366)

cc: --- --- District Administrator (--)